



**TESTIMONY of the HONORABLE TONY CLARK  
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and  
VICE CHAIRMAN, TELECOMMUNICATIONS COMMITTEE  
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS**

**BEFORE THE CONGRESSIONAL RURAL CAUCUS  
TELECOM TASK FORCE**

**Wednesday, November 17, 2004**

Congressmen Gutnecht and Stupak and other members of the Congressional Rural Caucus, thank you for the opportunity to testify today.

I am Tony Clark, President of the North Dakota Public Service Commission and Vice Chairman of the National Association of Regulatory Utility Commissioners (NARUC) Telecommunications Committee. NARUC represents the consensus policy positions of State public utility commissions in all 50 states, with jurisdiction over telecommunications, energy, water and other public utilities.

I commend you for establishing the Telecom Task Force and for convening this hearing to examine the full range of telecom reform issues before Congress through the lens of their impact on rural America. It is no secret that Congress will consider sweeping changes to the Telecommunications Act of 1996 next year and that many of the changes at issue will have a significant impact on rural constituents and the telecommunications services that connect them to the rest of the nation.

Today I'll highlight a number of issues that will figure prominently in the 2005 congressional telecom agenda and talk about NARUC's perspective on these issues.

**Universal Service.**

Universal service is a longstanding cornerstone of Federal and State telecommunications policy designed to ensure that consumers in rural, insular and high cost areas have access to a similar spectrum of telecommunications services as in urban areas, and at reasonably comparable rates. It also ensures basic service access for low-income consumers, Internet connections for schools and libraries and supports rural health care initiatives.

For many years, universal service policies were accomplished largely through “rate averaging” mandates that required dominant carriers to charge comparable rates for local service in every region and to redistribute the costs within the companies. As a rule, urban supported rural, long distance supported local, and business supported residential. Since 1996, as State and Federal policymakers have sought to facilitate a competitive telecom industry, those costs have shifted to explicit State and Federal universal service programs. And in many areas, implicit support mechanisms still exist to one degree or another. But increasingly, competitive markets and new technologies are upsetting the stability of older support regimes.

The current support mechanisms for universal service are becoming poorly matched with the evolving telecom market. As the long-distance industry declines and users migrate to newer services that are outside the current regulatory construct, the growing burden of maintaining universal service is falling on a shrinking base of customers, driving the contribution factor up and pushing universal service ever closer to a “tipping point” beyond which the whole system could become unsustainable.

The challenge for policymakers that are working to preserve universal service in a modern digital communications world, is to design a support system that is more consistent, reliable and sustainable.

Finding a fair and effective means of doing this will not be easy. A number of solutions have been proposed, from continuing the traditional revenue-based system to making flat fee assessments on each individual connection, or on each phone number. Each approach has its own advantages and drawbacks. NARUC may also be able to play an honest broker role on the distribution side of universal service. Just like the US Congress, NARUC has representation from all 50 states and must reconcile those interests when it comes to consensus positions.

#### **Anti-Deficiency Act and Universal Service.**

One issue that has recently emerged is with regard to the Anti-Deficiency Act and Universal Service. In the near-term, NARUC has urged Congress to help preserve the federal universal service program by exempting it from the Anti-Deficiency Act and the Miscellaneous Receipts Act. This is because the FCC recently directed the Universal Service Administration Company (USAC) to change its accounting methodology for the Universal Service Fund to the same methodology the Federal Government uses.

Under the new rules, USAC is required to have cash or federal securities on hand at least equal to the value of all of its outstanding Funding Commitment Decision Letters. Until the decision to impose the Anti-Deficiency Act on USAC, it was only required to have money on hand when the vendor submitted an invoice for actual payment, thus allowing the Universal Service Fund to accrue interest on the money in the interim between the issuance of the commitment letter and the completion of the work.

While USAC has adequate funds to pay all of its bills, these stringent accounting standards have created temporary cash flow problems that have delayed the release of new

commitments to schools and libraries across the country, as well as to the Rural Health Care Program. In August, USAC was forced to suspend issuing additional funding commitment letters. USAC estimates that a total of \$460 million in funding commitment letters have been held up, affecting roughly 4,000 schools and libraries. USAC has stated that it expects to be able to issue some funding commitments in the Schools and Libraries and Rural Health Care programs by late November. It is our understanding that USAC has had to liquidate some of its assets on short notice at a loss of \$4.5 million in order to meet the requirements of the Anti-Deficiency Act. Furthermore, due to these new accounting standards, USAC expects an overall annual loss of interest income of \$25 to \$30 million.

According to USAC's projections for 1st quarter 2005, the universal service assessment factor will need to be increased from its current rate of 8.9% to 12.78% to adequately ensure sufficient liquidity requirements of the Anti-Deficiency Act. This assessment rate is generally passed on to consumers in the form of line items on their telephone bills. This will mean higher rates for consumers, and will exacerbate pre-existing concerns about the sustainability of the current contribution method to support universal service. These estimates only reflect the impact of the Schools and Libraries program and Rural Health Care Support Mechanism. The FCC has deferred determining whether the high-cost and low-income programs are similarly situated. Thus, in the worst case the final impact could be substantially larger.

NARUC also supports an express exemption for the Universal Service program from the Miscellaneous Receipts Act. Currently, the Miscellaneous Receipts Act is not adversely affecting the Universal Service program because of a directive from the Office of Management and Budget that the Act is not applicable. Exemption from the Miscellaneous Receipts Act would make that decision even more clear, and codify that it is appropriate. From the inception of the program, funds have been held outside of the Treasury. An exemption from the Miscellaneous Receipts Act would aid in the stability of this program.

It is our understanding that similar exemptions already exist for both the Fish & Wildlife Service and the Highway Trust Fund. We are aware of other areas of the program that require close attention and possible modification. There are differing views on the appropriate direction for further reform. However, it is our strong view that applying the accounting standards contained in these acts does nothing to stabilize the fund or promote the goals of universal service, and in fact, jeopardizes the stability of the fund.

#### **State universal service funds.**

Universal service is both a State and Federal commitment. About 24 states have implemented programs that fill in the gaps missed by the federal fund, especially for remote high cost areas within large and populous states, like Texas, California and New York. These programs collectively distribute more than \$1.9 billion annually.

In addition to the direct benefits they provide to recipients, State programs provide an indirect benefit to more rural states by undertaking a burden that would otherwise fall on the federal fund. As competitive markets continue to drive out more implicit subsidies, the comparative burden on State and Federal programs alike will increase.

Unfortunately, State universal service funds are also in danger because federal courts have restricted them from assessing against services that are “interstate” in nature – and the FCC has classified a growing number of services, including VOIP services that exchange traffic with the public-switched telephone network (PSTN), as “interstate.” Any comprehensive reform of universal service must include a viable means for the growing number of state programs to be sustainable in a market increasingly be dominated by VOIP, wireless and other emerging services.

**Reforming the intercarrier compensation system.**

Inter-carrier compensation policies, which determine how carriers compensate one another for handling calls and leasing dedicated circuits, also have a significant impact on rural phone rates because rural carriers rely disproportionately on access charges, both interstate and intrastate, as a part of their revenue base. There are really only three sources of revenue for telecom carriers: end-user rates, universal service programs, and inter-carrier compensation.

The current inter-carrier compensation system was developed on a piecemeal basis over many years and now has different rates for terminating calls based on whether the requesting carrier is a competitive local carrier, an incumbent local carrier, a wireless carrier or a long-distance company and on whether the traffic is long-distance or local, intrastate or interstate in nature. These differentials have led to increasing market distortion as consumers choose cheaper wireless and calling-card options for long distance calls, and regulatory arbitrage as carriers seek “least cost routing” solutions to avoid higher access charges.

State and federal policymakers must ultimately work with all segments of industry to develop a unified, economically rational inter-carrier compensation system that minimizes the incentives for regulatory arbitrage, covers all carriers, provides an economic incentive for requesting carriers to interconnect and, when the public interest demands it, still allows states to develop reasonable retail rates for providers of last resort.

In May 2004, NARUC formed an Inter-carrier Compensation Task Force that issued general principles for a unified inter-carrier compensation system. The task force has since moderated an intensive dialogue among all industry segments, including the RBOCs, rural telcos, wireless, long-distance and cable providers, convening well-attended meetings in Missoula, Salt Lake City, Washington DC and Nashville. We are hopeful that this continuing dialogue will help the parties understand each other’s concerns and move toward an ultimate solution that is the best for consumers.

**Conclusion:**

In a constantly evolving telecom market, NARUC looks forward to working closely with federal policymakers to preserve our core interests in consumer protection, competition and universal service. We appreciate the leadership of the Congressional Rural Caucus and look forward to working with you in 2005 and beyond.